Supreme Court U.S.
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No. 00-

IN THE

Supreme Court of the United States

KENNETH P. KONTNY and JO ANN L. KONTNY,

Petitioners,

v.

UNITED STATES OF AMERICA,

Respondent.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

(1) Whether the Fifth Amendment's due process clause is violated when a revenue agent of the Internal Revenue Service (*i.e.*, a civil, ***not*** criminal agent) continues to investigate taxpayers, even after the agent has a firm indication that those taxpayers have engaged in fraud (*i.e.*, tax crimes) and as a result, those taxpayers make statements that are against their interest?

(2) Whether the Court of Appeals departed from this Court's decision in *Stinson v. United States,* 508 U.S. 36 (1993) by rejecting a provision in the commentary to the United States Sentencing Guidelines, which defines, in part, sophisticated concealment as "especially complex or especially intricate offense conduct"?

(3) Should the Court of Appeals review *de novo* a District Court's finding that the defendants' conduct rose to the level of sophisticated concealment, as the term is used in the United States Sentencing Guidelines?

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OPINIONS BELOW

The opinion of the United States Court of Appeals for the Seventh Circuit is reported as *United States v. Kontny*, 238 F.3d 815 (7th Cir. 2001) and is reproduced in Appendix A. The Judgment in a Criminal Case of *United States v. Kenneth P. Kontny* is not reported and is included in Appendix B. Appendix C contains the unreported Judgment in a Criminal Case of *United States v. Jo Ann L. Kontny*. The Memorandum and Order of Judge Shabaz, ruling on the Kontnys' Motion to Suppress, is Appendix D.

STATEMENT OF JURISDICTION

The Judgment of the United States Court of Appeals for the Seventh Circuit was rendered on January 4, 2001. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The Fifth Amendment to the United States Constitution provides in part:

> No person shall . . . be deprived of life, liberty, or property, without due process of law. . . .

The United States Sentencing Guidelines provide in part:

> If the offense involved sophisticated concealment, increase by **2** levels. United States Sentencing Commission, *Guidelines Manual* § § 2T1.1(b)(2); 2T1.4(b)(2).

STATEMENT OF THE CASE

This case concerns the Internal Revenue Service's ("IRS") investigation of Kenneth and Jo Ann Kontny. Specifically, at issue is whether, unbeknownst to the Kontnys, the IRS conducted a criminal investigation under the guise of a civil audit, thus misleading the Kontnys and lulling them into confessing to the IRS. This case also involves the question of whether the Kontnys' conduct rose to the level of "sophisticated concealment." This is significant because, for purposes of calculating their sentences under the United States Sentencing Guidelines, the District Court ordered a two point offense level enhancement for sophisticated concealment.

A. Background of the Case

The Kontnys own and operate a small business called Tri-State Mechanical, Inc. ("Tri-State") located in Ashland, Wisconsin. They have also operated another business, also located in Ashland, called KBK, Inc. ("KBK"). This case arises out of the IRS's contention that Kenneth and Jo Ann engaged in a criminal scheme to file false employment tax returns (IRS Form 941) in order to avoid the payment of withholding tax on overtime paid to employees of Tri-State.

Both Tri-State and KBK supply and install plumbing, heating, ventilation and air-conditioning equipment for businesses, public works projects, schools and local governments. Historically, Tri-State has employed between 25 and 30 workers at any given time. Jo Ann was the president and handled the bookkeeping. Kenneth was the Chief Executive Officer, and handled job bidding and job production.

Tri-State paid overtime to its employees at a straight time rate (*i.e.*, not at a rate of time and one-half). The employees received a check written on Tri-State's one checking account. However, the check they received was separate from their normal payroll check. Their payroll checks were on blue paper and were typed. Their overtime checks were on green paper and were handwritten.

From a tax standpoint, the arrangement that Tri-State had with its employees is problematic because the employees' earnings statements (*i.e.*, IRS Forms W-2), did not reflect the overtime payments. Further, overtime was not reported on Tri-State's books as a wage expense. Finally, there was no income or employment tax withholding on these earnings.

During the mid-1990s, some of Tri-State's employees sought to unionize. The Kontnys resisted this effort. As a result, certain disgruntled employees threatened to report Tri-State's payroll arrangement to the IRS. When the Kontnys did not yield, the disgruntled employees carried through on their threat and reported the Kontnys to the Criminal Investigation Division of the Internal Revenue Service.

In October 1994, a representative of the Local #11 Sheet Metals - Metal Workers Union walked into the IRS office in Duluth, Minnesota, and asked to speak to a criminal investigator. The union representative told the IRS that several employees of a Wisconsin business wanted to come forward with details about a tax evasion scheme. The union representative explained that he wanted to obtain immunity for the employees.

Although the case started with the Criminal Investigation Division of the IRS, it was assigned to a civil agent, Revenue Agent James Furnas.[1] Agent Furnas was familiar with Jo Ann Kontny (as was she with him) because a few years earlier Agent Furnas conducted a civil audit of KBK.

Agent Furnas interviewed the four disgruntled employees. All of these employees informed him that they received two checks from Tri-State, one for regular time and one for overtime. They also informed him that the Kontnys did not withhold taxes from their overtime checks nor were these payments reported on their Forms W-2. One employee gave Agent Furnas his paycheck stubs.

Agent Furnas used these employee interviews to confirm the existence of the Kontnys' alleged criminal tax scheme. He confirmed that the disgruntled workers were indeed employees of Tri-State and not independent contractors. He verified that the overtime paid to the employees was for the same type of work that they performed during regular hours and that Tri-State did not issue to them a Form 1099 (*i.e.*, the form normally given to an independent contractor). Agent Furnas also learned that Tri-State employees believed that they would get fired if they did not go along with the scheme.

Agent Furnas obtained detailed information regarding the manner in which the Kontnys conducted their alleged criminal activity. The employees explained to him that they submitted time cards for non-overtime hours (*i.e.*, 40 hours or less per week). However, they reported overtime on a

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1. IRS revenue agents handle civil cases; Special Agents handle criminal cases.

separate slip of paper, which they paper clipped to their time cards. The employees would place their time cards and attached overtime slips in a special slot on a board, after which Jo Ann Kontny would take the time cards and the slips and enter the amounts on the time cards into a computer. The employees also told Agent Furnas that the Kontny's scheme could have spanned as many as ten years, and that all the employees had some degree of knowledge about the scheme. One employee told Agent Furnas that he was never reimbursed for travel. This is significant because Agent Furnas could now rule out the possibility that the Kontnys issued the second checks as reimbursement for travel expense. Finally, the employees gave the names of five additional employees who were willing to come forward and corroborate their story.

On February 23, 1995, after completing his interviews of the employees, Agent Furnas called Jo Ann Kontny to schedule a meeting. On this same day, Agent Furnas also met with his group manager and advised him that he had a "first indication" of fraud in the Kontny case.

On March 13, 1995, Agent Furnas went to Tri-State and met with Jo Ann Kontny. He explained that his purpose was to investigate specific allegations that withholding tax was not being taken out of overtime payments to employees. Jo Ann Kontny incorrectly told Agent Furnas that all wages were reported correctly. She also asked if she needed an attorney. Agent Furnas told her that this was a civil examination and that the need for an attorney was up to her. He also told her that he was looking for additional tax, and that if he had reason to believe there was fraud, he would refer the matter to the Criminal Investigation Division of the IRS.

Agent Furnas interviewed both Kenneth and Jo Ann Kontny for a number of hours. During the course of this interview, he obtained numerous confessions from the Kontnys. At trial, Agent Furnas testified that Kenneth Kontny explained that Tri-State had paid overtime to workers, which had not been included in Tri-State's payroll system and had been deducted by Tri-State as costs of goods sold. Agent Furnas also testified that Kenneth Kontny offered to file amended Forms W-2 for the workers. In addition, at trial, Agent Furnas contended that Jo Ann Kontny acknowledged that she knew of the requirement that overtime wages must be included in Tri-State's payroll, and that she admitted to paying overtime wages on separate checks and then entered those amounts as lump sums for materials, supplies and costs on Tri-State's ledger.

Ultimately, as a result of his interviews, Agent Furnas prepared a fraud referral report (IRS Form 2797) to the Criminal Investigation Division. This report was forwarded to the Criminal Investigation Division of the IRS.

B. The Kontnys' Motion to Suppress

The Kontnys were indicted by a Grand Jury sitting in the Western District of Wisconsin on numerous counts of violating various tax crimes.[2] On March 17, 2000, the Kontnys filed a motion to suppress all statements, books, records and documents that the IRS obtained from them in

2. Both Kenneth and Jo Ann Kontny were charged with conspiracy to defraud the United States (18 U.S.C. § 371). Kenneth Kontny was also charged with a number of counts of aiding and assisting in the preparation and presentation of a false tax return (26 U.S.C. § 7206(2)). Jo Ann Kontny was charged with a number of counts of filing a false tax return (26 U.S.C. § 7206(1)).

violation of their Fourth and Fifth Amendment rights. They argued that by March 13, 1995, Revenue Agent Furnas had developed a "firm indication of fraud," which required him to refer the case to the Criminal Investigation Division. However, instead of making this referral, Agent Furnas continued to investigate the Kontnys for criminal tax violations. Further, Agent Furnas falsely told the Kontnys that he was merely conducting a civil audit. The Kontnys argued that in reliance on Agent Furnas's implicit and explicit representations that he was conducting a civil investigation, they made admissions to Agent Furnas and provided him with records, which they otherwise would not have disclosed. The Kontnys reasoned that Agent Furnas's falsity and their reliance made their confessions involuntary and, as such, in violation of their Fourth and Fifth Amendment rights.

On May 1, 2000, Judge Shabaz denied the Kontnys' Motion to Suppress. Judge Shabaz concluded that Agent Furnas did not have a firm indication of fraud prior to March 13, 1995; nor were the Kontnys misled or deceived by anything that Agent Furnas said or did on that date.

> There is no evidence in the record that Agent Furnas affirmatively misled the defendants as to the true nature of his investigation. He advised Jo Ann Kontny of the allegations that had been made concerning the payment of overtime to employees. He also told her that if he found some corroboration of the allegations he would refer the matter to the Criminal Investigation Division. The Court cannot conclude that the defendants believe they had no potential criminal exposure. The defendants were not misled or deceived by anything that Agent Furnas said or did on

> March 13, 1995. . . . Prior to March 13, 1995, Agent Furnas had only unsubstantiated allegations from disgruntled employees that Tri-State had not paid employment taxes. . . . Agent Furnas did not have firm indications of fraud prior to March 13, 1995. . . . (App. D at 40a-41a.)

C. Trial and Sentencing

The Kontnys were tried in Federal District Court. That court had jurisdiction pursuant to 18 U.S.C. § 3231. At this trial, Agent Furnas testified about the confessions he obtained from the Kontnys. Further, the documents he took on March 13, 1995 were admitted into evidence. A jury found Kenneth and Jo Ann Kontny guilty of various tax crimes.

On July 26, 2000, Judge Shabaz conducted a sentencing hearing, where among other things, he had to decide whether to increase the Kontnys offense levels by two points for engaging in "sophisticated concealment." Judge Shabaz applied the sophisticated concealment enhancement contained in Guideline Sections 2T1.1(b)(2) and 2T1.4(b)(2).

Kenneth Kontny received a sentence of incarceration of 32 months, which he is currently serving. Jo Ann Kontny received a sentence of incarceration of 27 months, which she is currently serving.

D. The Decision of the Seventh Circuit

The Kontnys appealed to the Court of Appeals for the Seventh Circuit. Their arguments on appeal were two-fold. First, they argued that under the law of the Seventh Circuit, most recently articulated in *United States v. Peters*, 153 F.3d

445 (7th Cir. 1998), the statements made to Agent Furnas and the documents he took should have been suppressed because Agent Furnas affirmatively misled the Kontnys and the Kontnys relied on these representations to their detriment.

Second, the Kontnys argued that their actions did not constitute sophisticated concealment, within the meaning of Guideline Sections 2T1.1(b)(2) and 2T1.4(b)(2). They pointed to the application notes behind these sections, which define sophisticated concealment as "especially complex or especially intricate offense conduct in which deliberate steps are taken to make the offense, or its extent, difficult to detect." They contended that their actions were no more complex than those taken in any other tax case, and that they did not rise to the level of "especially complex or especially intricate" conduct.

Both of the Kontny's arguments were rejected by the Court of Appeals. The Court ruled that Agent Furnas did not affirmatively mislead the Kontnys nor did they rely on Agent Furnas's actions to their detriment. Further, the Court found that even if Agent Furnas had misled the Kontnys, only in the most egregious situations would suppression be appropriate. *Kontny*, 238 F.3d at 818-819.

Regarding the Kontnys' second argument, the Court of Appeals affirmed the district court's decision that the sophisticated concealment enhancement is appropriate. The Court did this in spite of the fact that it found that the Kontnys' conduct was not sophisticated in the lay sense of the word. *Id.* at 820.

REASONS FOR GRANTING THE WRIT

I. A SPLIT IN THE CIRCUITS EXISTS ON THE QUESTION OF WHETHER A CONSTITUTIONAL VIOLATION OCCURRED.

A split in the circuits exists on the question of whether suppression is appropriate when a revenue agent conducts a criminal investigation under the guise of a civil audit and a taxpayer makes damaging admissions to that agent. The Seventh Circuit's decision in *Kontny* makes this split even more pronounced.

At the one end of the spectrum is the Sixth Circuit's decision in *United States v. McKee*, 192 F.3d 535 (6th Cir. 1999). *McKee* held that once a revenue agent (*i.e.*, a civil agent) has a firm indication of fraud, that agent must terminate his or her investigation. That revenue agent may not conduct a criminal tax investigation. When a revenue agent conducts a criminal audit under the guise of a civil audit, and a taxpayer makes a confession to that agent, that confession is involuntary and a Constitutional violation occurs. *Id.* at 542. The Court explained that, as a practical matter, when a taxpayer makes damaging admissions to a revenue agent, after the agent has a firm indication of fraud: (i) the agent has made affirmative misrepresentations to the taxpayer; and (ii) the taxpayer has relied on those misrepresentations to her detriment. *Id.*

The Sixth Circuit's view is the most taxpayer-friendly view of when statements made to a revenue agent should be suppressed. At the midpoint of the spectrum of authority are the decisions of the Fifth, Seventh (pre-*Kontny*) and Eighth Circuits. Prior to *Kontny*, these circuits all took similar positions, which required suppression if similar multi-part tests were met.

The Fifth Circuit's test (*See United States v. Caldwell*, 820 F.2d 1395 (5th Cir. 1987)) mandates suppression if the taxpayer can show that (i) the IRS made an affirmative representation that the investigation was routine when, in fact, it was a criminal investigation; and (ii) that the taxpayer relied on this misrepresentation. *Id.* at 1399. The Seventh Circuit's test was similar (*See United States v. Serlin*, 707 F.2d 953 (7th Cir. 1983)); and *United States v. Peters*, 153 F.3d 445 (7th Cir. 1998)).[3] Prior to *Kontny*, this Circuit required suppression when the taxpayer established that (i) the IRS agents misled her as to the true nature of their investigation; and (ii) this affirmative misleading was a material factor in her decision to give information to the agents. *Peters*, 153 F.2d at 456. With regard to the first factor — whether affirmative misleading took place — the question of whether the agents had a firm indication of fraud is a factor, which serves as a guide for the district court, but is not necessarily determinative on this issue. *Id.*

The Eighth Circuit's test (*See United States v. Wadena*, 152 F.3d 831 (8th Cir. 1998))) is a three-part test. This test requires suppression if the taxpayer can show that: (i) the IRS had firm indications of fraud by the defendant; (ii) there is clear and convincing evidence that the IRS affirmatively and intentionally misled the defendant; and (iii) the IRS's conduct resulted in prejudice to the defendant's constitutional rights. *Id.* at 851.

At the opposite end of the spectrum is the Seventh Circuit's decision in *Kontny*. *Kontny* creates a new standard, which rules out suppression in most cases. If the Sixth

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3. After the Seventh Circuit's decision in *Kontny*, it is unclear what, if any, portion of this test survives.

Circuit's holding in *McKee* is taxpayer-friendly, *Kontny* is taxpayer-hostile. In *Kontny*, the Seventh Circuit found that:

> Trickery, deceit, even impersonation [on the part of a Revenue Agent] do not render a confession inadmissible, certainly in non-custodial situations and usually in custodial ones as well, unless the government agents make threats or promises. *Kontny*, 238 F.3d at 817. (Citations omitted.)

The Court observed that suppression of the Kontnys' statements would not be appropriate, regardless of whether Agent Furnas had a firm indication of fraud.

> So even if Furnas was pretending to be conducting a civil investigation but was really, as the appeal argues, conducting a criminal one, this would not, under the rules that govern the admissibility of incriminating statements (written or oral) made to government officers even by a suspect who is in custody, make the statements inadmissible. *Id.* at 818. (Emphasis omitted.)

The Court limited the times when the false and misleading actions of a revenue agent might require suppression of a taxpayer's statements to only the most egregious of cases. By way of illustration, the Court found that:

> [I]f [Revenue Agent] Furnas had pretended to be a representative of the Mob and told the Kontnys that they would be killed if they didn't turn over their business records to him, or pretended to be an Assistant U.S. Attorney and assured them they would not be prosecuted if they cooperated with

him, the Kontnys might have a sound ground for exclusion. *Id.* at 819.

In essence, *Kontny* overrules the Seventh Circuit's prior decisions in *Serlin* and *Peters*. The clear import of *Kontny* is that in almost all cases (certainly all cases that are less extreme than the examples given by the Court) a revenue agent may engage in trickery, deceit and impersonation in order to secure a confession. Thus, the Seventh Circuit's decision in *Kontny* stands in stark contrast to the rule of the Sixth Circuit in *McKee*. The issue is further muddied by the precedent of the Fifth and Eighth Circuits, as well as the Seventh Circuit's previous rulings, which all fall between *McKee* and *Kontny*.

The question of what steps an agent of the IRS may undertake in order to obtain a criminal confession has significant ramifications for this country's entire tax system. The United States' tax collection system is unique from virtually all other tax systems in the world. In this country, paying one's taxes is the norm, not the exception. Tax evasion is not ubiquitous. In essence, our nation's system is quasi-voluntary. It relies very heavily on the good faith and voluntary disclosures of taxpayers. This, therefore, heightens the corresponding obligation of the IRS and its agents to deal in good faith with the taxpayers. Once taxpayers become convinced that the IRS is not being forthright and honest, this country's tax system will cease to be a quasi-voluntary system and will become more like most of the world's other tax systems where tax evasion is routine.

Accordingly, this Court's guidance is needed in order to bring the circuits into harmony.

II. THE COURT OF APPEALS IGNORED THE COMMENTARY TO THE GUIDELINES.

This Court has ruled that the commentary contained in the Sentencing Guidelines binds federal courts. *Stinson v. United States*, 508 U.S. 36, 42-43 (1993).[4] Further, the guidelines themselves provide that "[f]ailure to follow such [guideline] commentary could constitute an incorrect application of the guidelines, subjecting the sentence to possible reversal on appeal." United States Sentencing Commission, *Guidelines Manual* § 1B1.7. (*See also* 18 U.S.C. § 3742(f)(1)). The Seventh Circuit failed to adhere to these mandates and ignored a portion of the Guideline's Commentary.

Specifically, when calculating a criminal sentence, the United States Sentencing Guidelines require the District Court to first determine the appropriate base offense level. In the Kontnys' case, after finding this base level, Judge Shabaz ordered a two-point increase for each of the Kontnys, based upon his conclusion that their tax scheme involved sophisticated concealment. *See* United States Sentencing Commission, *Guidelines Manual*, § § 2T1.1(b)(2); 2T1.4(b)(2) (Nov. 2000).[5] The Court of Appeals affirmed

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4. In *Stinson*, this court found that its holding in *Williams v. United States*, 503 U.S. 193 (1992) that the policy statements contained in the guidelines bind federal courts, should be applied with equal force to the commentary in the guidelines. *Stinson*, 508 U.S. at 43.

5. The citation of two Guideline Sections requires some explanation. Section 2T1.1 applies to the crime of filing a false tax return (26 U.S.C. § 7206(1),) whereas Section 2T1.4 applies to the crime of aiding and abetting in the filing of a false tax return

(Cont'd)

this ruling. However, in so doing it ignored the definition of sophisticated concealment contained in the Guideline's Commentary. As a result, in direct opposition to this Court's ruling in *Stinson*, the Seventh Circuit created a new, much broader definition of sophisticated concealment.

The Guidelines require a two-point offense level increase "[i]f the offense involved sophisticated concealment. . . ." The Guideline's Commentary provides that sophisticated concealment "means *especially complex* or *especially intricate offense* conduct in which deliberate steps are taken to make the offense, or its extent, difficult to detect." United States Sentencing Commission, *Guidelines Manual* § 2T1.1,

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(Cont'd)

(26 U.S.C. § 7206(2)). They both impose a two-point enhancement for sophisticated concealment. Further, Section 2T1.1, application note 4 and Section 2T1.4, application note 3, both define sophisticated concealment in the same manner.

The Court of Appeals' decision refers solely to Guideline Section 2T1.1(4)(b)(2). Kenneth Kontny was charged with violating 26 U.S.C. § 7206(2); thus, this is the appropriate Guideline Section. However, Jo Ann Kontny was charged with violating 26 U.S.C. § 7206(1), meaning that the appropriate Guideline Section with regard to her is 2T1.1(b)(2).

This matter is further confused by the fact that the Judgment in a Criminal Case attributable to Kenneth Kontny states that he was convicted of five counts of violating 26 U.S.C. § 7206(1). This is not correct. He was convicted of violating 26 U.S.C. § 7206(2). However, from a practical standpoint, since both 26 U.S.C. §§ 7206(1) and (2) are treated the same under the Sentencing Guidelines, and subsection 2T1.1(b)(2) and 2T1.4(b)(2) are verbatim the same, these errors are not significant and appear to be typographical.

Comment n.4 and § 2T1.4, Comment n.3. (Emphasis added.) Thus, in order for the offense level enhancement to apply, a court must find that a taxpayer undertook steps to make his or her offense difficult to detect, and those steps were either especially complex or especially intricate.

The Seventh Circuit did more than merely affirm Judge Shabaz's ruling that the Kontnys' conduct rose to the level of sophisticated concealment. Rather, the Court made a point of rewriting the definition of sophisticated concealment. Under this new definition, the sophisticated concealment enhancement is not limited to "especially complex or especially intricate offense conduct." Instead, the Court defined sophisticated concealment in the following manner:

> The essence of the definition [of sophisticated concealment] is merely "deliberate steps taken to make the offense . . . difficult to detect." *Kontny*, 238 F.3d at 821.

Thus, by ignoring the express language of the Guideline's Commentary, the Seventh Circuit modified the enhancement from one that punishes "sophisticated" concealment to one that punishes mere "concealment." This new definition is particularly troubling because most tax fraud cases involve some steps disguised to make the offense difficult to detect. Thus, the Court's new definition of sophisticated concealment will result in the enhancement being applied in all but the most vanilla tax cases.[6]

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6. This result does not seem to be shared by all members of the Seventh Circuit. Recently, another panel of the Seventh Circuit, where two of the three members were not part of the Kontny panel, reviewed another of Judge Shabaz's decisions to apply the (Cont'd)

Applying its new definition, the Seventh Circuit found that the Kontnys' conduct constituted sophisticated concealment. However, this would not have been so, had the Court applied the entire definition of sophisticated concealment contained in the Guideline's Commentary. Indeed, in essence, the Court conceded that the conduct of the Kontnys was not especially complex or especially intricate. The court observed:

> [The Kontnys actions] **were not very sophisticated in the lay sense of the word, especially in context**. By creating a fraud that involved a knowing participation of more than two dozen employees, they not only armed the employees to blackmail them, but greatly increased the risk of eventual detection. . . . *Id.* at 820. (Emphasis added.)

Accordingly, it is appropriate and necessary for this Court to grant *certiorari* in this case.

III. A SPLIT IN THE CIRCUITS EXISTS ON THE APPROPRIATE STANDARD OF REVIEW.

The Seventh Circuit reviewed for clear error Judge Shabaz's decision to enhance the Kontnys' sentences for sophisticated concealment. *Kontny*, 238 F.3d at 821.

(Cont'd)
sophisticated concealment enhancement. This panel observed that the sophisticated concealment "enhancement should not be applied where the concealment is no more intricate or complex than the routine tax evasion case, since all such offenses involve some planning and this is already incorporated into the base offense level." *United States v. Utecht*, 238 F.3d 882, 889 (7th Cir. 2001).

By applying the clear error standard, the Seventh Circuit implicitly found that the question of whether a tax scheme meets the definition of sophisticated concealment is a factual and not a legal question.

The Courts of Appeal are in agreement that a district court's factual findings underlying the application of Sentencing Guidelines are reviewed for clear error. *United States v. Huggins*, 191 F.3d 532, 539 (4th Cir. 1999); *United States v. Huskey*, 137 F.3d 283, 285 (5th Cir. 1998); *United States v. Pierce*, 17 F.3d 146, 151 (6th Cir. 1994); *United States v. Collado*, 975 F.2d 985, 990 (3d Cir. 1992). Likewise, the circuits are in agreement that legal questions receive *de novo* review. *United States v. Frierson*, 232 F.3d 902 (10th Cir. 2000); *United States v. Cianci*, 154 F.3d 106, 109 (3d Cir. 1998). Many federal appellate courts have found that the standard for reviewing the application of a Sentencing Guideline to the facts is *de novo* (or *de novo* with due deference). *United States v. Aragbaye*, 234 F.3d 1101, 1104 (9th Cir. 2000); *United States v. Huskey*, 137 F.3d 283, 285; *United States v. Powell*, 124 F.3d 655, 663 (5th Cir. 1997); *United States v. Clements*, 73 F.3d 1330, 1338 (5th Cir. 1996); *United States v. Pierce*, 17 F.3d at 151; *United States v. Ford*, 989 F.2d 347, 349 (9th Cir. 1993). However, the circuits have applied varying standards of review when interpreting different sentencing guidelines. While the interpretation of one term in a guideline receives clear error review, the interpretation of another is reviewed *de novo*. *United States v. Clements*, 73 F.3d 1330; *United States v. Ford*, 989 F.2d 347. This contrast exists not only between the circuits, but within the circuits as well. *United States v. Lewis*, 93 F.3d 1075 (2nd Cir. 1996) (reviewing "sophisticated means" *de novo*); *United States v. Mapp*, 170 F.3d 328 (2d Cir. 1999) (reviewing "related" for

clear error); *Ford*, 989 F.2d 347 (the Ninth Circuit reviewed "criminal activity" *de novo*); *United States v. Aragbaye*, 234 F.3d 1101 (the Ninth Circuit reviewed "sophisticated means" for clear error).

The Circuits are split in their determinations as to which standard of review should apply to the sophisticated concealment enhancement.[7] The Second, Third and Sixth Circuits have applied a *de novo* standard. *United States v. Morris*, 2001 U.S. App. LEXIS 1894 (6th Cir. January 23, 2001); *United States v. Lewis*, 93 F.3d 1075. In *United States v. Lewis*, the Second Circuit Court of Appeals reviewed the application of section 2T1.1(b)(2) to the facts *de novo*, giving due deference to the sentencing court. *Lewis, Supra,* 93 F.3d at 1079. The court acknowledged a host of Second Circuit cases applying this *de novo* standard to other guideline provisions, which were "no less fact-intensive or subjective than the sophisticated means enhancement." *Id.*[8] Four years later, the Second Circuit continued the use of this *de novo* standard when reviewing a sophisticated means determination by the district court. *United States v. Middlemiss*, 217 F.3d 112, 123 (2d Cir. 2000). The Sixth Circuit has reviewed *de novo* the

7. Prior to November 1, 1998, section 2T1.1(b)(2) contained the phrase "sophisticated means." The primary purpose of the change was to conform the language of the tax guidelines to the essentially equivalent language in the fraud guidelines. Federal Sentencing Guidelines Handbook APP-169 Appendix C, Amendment 577.

8. The court cited *United States v. Palmer*, 68 F.3d 52, 54-55 (2d Cir. 1995) ("crime of violence"); *United States v. Gaston*, 68 F.3d 1466, 1468 (2d Cir. 1995) (per curium) ("minimal" or "minor" role); *United States v. Broderson*, 67 F.3d 452, 455 (2d Cir. 1995) ("related" robbery convictions); *United States v. Mafanya*, 24 F.3d 412-414 (2d Cir. 1994) (obstruction of justice).

sophisticated means enhancement, as applied to the facts, on a number of occasions. *United States v. Morris*, 2001 U.S. App. LEXIS 1894 (6th Cir. January 23, 2001); *United States v. Pierce*, 17 F.3d 146, 151; *see also United States v. Spine*, 215 F.3d 1328 (6th Cir. 2000) (giving due deference to the district court's application of the guideline to the facts).

Conversely, the Fifth, Seventh and Ninth circuits have reviewed the sophisticated means enhancement for clear error. *United States v. Aragbaye*, 234 F.3d 1101; *United States v. Powell*, 124 F.3d 655; *United States v. Friend*, 104 F.3d 127 (7th Cir. 1997). The Fifth Circuit in *Powell* held that whether sophisticated means were used under section 2T1.1(b)(2) is a factual determination reviewed for clear error. *United States v. Powell*, 125 F.3d 655, 666 (5th Cir. 1997); *see also United States v. Clements*, 73 F.3d at 1340. Likewise, the Seventh Circuit has repeatedly found that a finding that sophisticated means were used is a fact-based finding reviewed only for clear error. *United States v. Friend*, 104 F.3d 127, 129; *United States v. Madoch*, 108 F.3d 761, 765 (7th Cir. 1997); *United States v. Whitson*, 125 F.3d 1071, 1075 (7th Cir. 1997). Finally, the Ninth Circuit has also held that a finding that the sophisticated means enhancement is applicable is a factual determination reviewed for clear error. *United States v. Aragbaye*, 234 F.3d at 1108; *United States v. Ford*, 989 F.2d at 351.

The circuits vary in the application of standards of review used in other areas of sentencing guideline use as well. The First Circuit gave plenary review to a district court's determination that certain offenses were unrelated. *United States v. Correa*, 114 F.3d 314, 317 (1st Cir. 1997). Likewise, other Courts of Appeal have held that a district court's determination of relatedness is reviewed *de novo*.

United States v. Huskey, 137 F.3d at 285; *United States v. Allen*, 153 F.3d 1037, 1045 (9th Cir. 1998) (we review *de novo* the question whether two prior sentences are related). The Tenth Circuit has held that a review of the application of sentencing guidelines, which includes the meaning of the term "related," is *de novo*. *United States v. Wiseman*, 172 F.3d 1196, 1219 (10th Cir. 1999). However, the Tenth Circuit ruled that whether offenses are related is a factual question reviewed for clear error. *Id.* The Second and Eleventh Circuits have also found that a finding as to whether prior convictions are factually related is reviewed only for clear error. *United States v. Mapp*, 170 F.3d at 338; *United States v. Mullens*, 65 F.3d 1560, 1565 (11th Cir. 1995).

Not only do the above citations illustrate a variation among the circuit courts on how these issues have been reviewed, but also a variation within many of these circuits as well. The Ninth Circuit has held that "criminal activity" and "related" are reviewed *de novo* while "sophisticated means" received a clear error review. *Ford*, 989 F.2d 347 (criminal activity); *Allen*, 153 F.3d 1037 (related); *Aragbaye*, 234 F.3d 1101 (sophisticated means). The Fifth Circuit has reviewed "more than minimal planning" and "sophisticated means" for clear error, while "related" received *de novo* review. *Clements*, 73 F.3d 1330 (more than minimal planning); *Powell*, 124 F.3d 655 (sophisticated means); *Huskey*, 137 F.3d 283 (related). The Second Circuit ruled that "sophisticated means" receives *de novo* review while "related" is examined for clear error. *Lewis*, 93 F.3d 1075 (sophisticated means); *Mapp*, 170 F.3d 328 (related). This variation (among and within the circuits) on how courts are to review the application of the sentencing guidelines and enhancements thereto has left the courts without clear guidance on the appropriate standard of review to be used.

Recently, this Court has decided *Buford v. United States*, __ U.S. __ [2001 WL 265345] (March 20, 2001). In *Buford*, this Court considered whether the petitioners' prior convictions in state courts were "related" within the meaning of Guideline Section 4A1.2(a)(2) and whether the Courts of Appeal should have reviewed the district court's determination on this question *de novo*, rather than for clear error. This Court affirmed the Seventh Circuit's decision to review the district court's decision deferentially, rather than *de novo*. This conclusion was based on the "fact-bound nature of the legal decision, the comparatively greater expertise of the district court, and the limited value of uniform court of appeals precedence. . . ." *Id.*

The question now before this Court is significantly different from the question presented in *Buford*. The issue of whether the sophisticated concealment enhancement is appropriate is much different from whether two sentences are "related." Generally, with respect to the sophisticated concealment enhancement, there is no significant factual dispute. Indeed, in the case of *Kontny*, the facts are not in dispute. All that is at issue is whether these facts rise to the legal definition of "sophisticated concealment," within the meaning contained in the Guideline's Commentary. Further, in *Buford*, the issue pertained to the procedural mechanics of prior sentencings. As this Court noted, this is a matter that a District Court would be much more familiar with than a Court of Appeals. *Id.* However, a District Court is no better suited than a Court of Appeals to determine whether the legal definition of "sophisticated concealment" has been met.

Finally, in *Buford*, this Court noted that with respect to the facts of that case, there is limited value to the existence of uniform Court of Appeals precedent. This is because the issue in *Buford* is somewhat unique and uncommon.

However, in light of the definition the Seventh Circuit used for the term "sophisticated concealment," it is reasonable to expect that this enhancement will be applied in most, if not all, subsequent tax cases. Thus, the creation of a clear definition of "sophisticated concealment" is of the utmost importance, the precedential value of which will be invaluable.

Accordingly, it is necessary for this Court to harmonize the circuits. For this reason it is appropriate to grant the Kontnys' Petition for Certiorari.

CONCLUSION

For the above reasons, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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APPENDIX

APPENDIX A — OPINION OF THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT DATED AND DECIDED JANUARY 4, 2001

UNITED STATES COURT OF APPEALS
SEVENTH CIRCUIT

UNITED STATES OF AMERICA,

Plaintiff-Appellee,

v.

KENNETH P. KONTNY and JOANN L. KONTNY,

Defendants-Appellants.

Nos. 00-3004, 00-3006.

Argued Dec. 5, 2000.
Decided Jan. 4, 2001.

* * *

Before POSNER, EASTERBROOK, and EVANS, Circuit Judges.

POSNER, Circuit Judge.

The Kontnys were convicted of fraudulent nonpayment of federal payroll taxes and sentenced to prison. Their appeal complains about the denial of their motion to suppress documents and statements that they gave to an Internal

Appendix A

Revenue Agent and about a sentencing increase that they received by virtue of the "sophisticated" character of their fraud.

The Fair Labor Standards Act requires employers to pay their hourly employees time and a half for overtime (that is, hours worked above 40 hours a week), but, of course, the overtime wage is taxable income to the employee. To defeat both the overtime and tax laws, the Kontnys, who own an equipment-supply business that employs 25 to 30 workers, concocted the following scheme. They would pay the workers normal wages rather than time and a half for overtime work but not report the overtime wages to the government as taxable income, thus making it easy (or easier) for the workers to avoid detection if they did not report this income on their tax returns. The employees benefited from this scheme by obtaining a greater after-tax income and the Kontnys by not paying either overtime wages at the rate of 1.5 times regular wages or payroll taxes on the overtime wages.

The scheme continued for at least a decade until the Kontnys became embroiled in a bitter labor dispute with their workers. One of them decided to tattle to the government. He visited an office of the IRS and was interviewed by Special Agent Babbitt, a criminal investigator. The matter was turned over to Revenue Agent Furnas to investigate. Revenue agents, unlike special agents, conduct civil rather than criminal investigations. Furnas interviewed a number of employees of the Kontnys' company and concluded that despite their disgruntlement over the labor dispute, they

might well be telling the truth. In that event the Kontnys had committed a fraud; and tax fraud is criminal, though more often handled on a civil than on a criminal basis.

Furnas requested an interview with the Kontnys. They agreed. At the interview he explained that he was investigating allegations that they had failed to withhold payroll taxes from overtime payments to their employees. Before Mr. Kontny arrived for the interview, Mrs. Kontny asked Furnas whether she needed to have a lawyer present for the interrogation. He replied that this was "a civil exam" and it was up to her to decide whether she needed to have a lawyer present. But he added that if he discovered fraud he would refer the matter for a criminal investigation. He asked her for various business records, which she gave him, and she made some statements that were later used against her at trial, for example that she realized that payroll taxes have to be withheld from overtime wages. In a follow-up phone call from Furnas a few days later she mentioned that she had shredded some checks that Furnas had inquired about. At the mention of the shredded checks his suspicions crystallized and he decided that he now had firm indications that the Kontnys had committed tax fraud and he turned the case over to the criminal investigatory arm of the IRS and had no further contact with the Kontnys.

As an original matter it is extremely difficult to see what possible basis there could be for a motion to suppress in this case. Confessions or other admissions obtained in the course of an interrogation are deemed involuntary and therefore inadmissible only if they are procured by threats or promises. Bram v. United States, 168 U.S. 532, 542-43, 18 S.Ct. 183,

42 L.Ed. 568 (1897); Johnson v. Trigg, 28 F.3d 639, 641-42 (7th Cir.1994); United States v. Glover, 104 F.3d 1570, 1579 (10th Cir.1997); United States v. Guerrero, 847 F.2d 1363, 1366 (9th Cir.1988). The Miranda rule is not in play here since the interrogation of the Kontnys by agent Furnas was not custodial. Beckwith v. United States, 425 U.S. 341, 96 S.Ct. 1612, 48 L.Ed.2d 1 (1976); compare Mathis v. United States, 391 U.S. 1, 88 S.Ct. 1503, 20 L.Ed.2d 381 (1968). But the fact that the Kontnys were not in custody has a broader significance. Virtually all cases involving coerced confessions involve the questioning of a suspect who is in police custody, an inherently intimidating situation in which people find it difficult to stand up for their rights or even to think straight. The situation is different when a person who does not even know that he is a criminal suspect (that is a premise of the Kontnys' appeal) is being interviewed in his home, and by a civil rather than a criminal investigator to boot. Furnas was unarmed, un-uniformed, unaccompanied. The Kontnys were at no disadvantage in dealing with him. They were under no pressure to answer his questions. Any answers they gave were voluntary.

Trickery, deceit, even impersonation do not render a confession inadmissible, certainly in noncustodial situations and usually in custodial ones as well, unless government agents make threats or promises. Frazier v. Cupp, 394 U.S. 731, 739, 89 S.Ct. 1420, 22 L.Ed.2d 684 (1969); Holland v. McGinnis, 963 F.2d 1044, 1051 (7th Cir.1992); United States v. Rutledge, 900 F.2d 1127, 1131 (7th Cir.1990) ("far from making the police a fiduciary of the suspect, the law permits the police to pressure and cajole, conceal material facts, and actively mislead"); United States v. Byram, 145 F.3d 405,

408 (1st Cir.1998) ("trickery is not automatically coercion. Indeed, the police commonly engage in such ruses as suggesting to a suspect that a confederate has just confessed or that police have or will secure physical evidence against the suspect. While the line between ruse and coercion is sometimes blurred, confessions procured by deceits have been held voluntary in a number of situations"). And these were custodial cases. Nothing is more common in the noncustodial setting of police investigations than for an undercover police officer to extract a damaging admission from a criminal suspect simply by pretending to be another criminal. The admission is usable in evidence against the suspect even though he would never have spilled the beans to the officer had he known the officer's status. Planting informers is not an unconstitutional method of collecting evidence for use in criminal trials. Illinois v. Perkins, 496 U.S. 292, 298-99, 110 S.Ct. 2394, 110 L.Ed.2d 243 (1990); Hoffa v. United States, 385 U.S. 293, 303-04, 87 S.Ct. 408, 17 L.Ed.2d 374 (1966). There is no right to require secrecy of the people whom one confides in.

So even if Furnas was pretending to be conducting a civil investigation but was really, as the appeal argues, conducting a criminal one, this would not, under the rules that govern the admissibility of incriminating statements (written or oral) made to government officers even by a suspect who is in custody, make the statements inadmissible. The circumstances did not remotely prevent the Kontnys from making a rational decision about whether to play ball with Furnas. United States v. Lawal, 231 F.3d 1045, 1048 (7th Cir.2000) ("a confession is voluntary if the totality of the circumstances demonstrates that it was the product of

rational intellect and not the result of physical abuse, psychological intimidation, or deceptive interrogation tactics calculated to overcome the defendant's free will"); United States v. Westbrook, 125 F.3d 996, 1006 (7th Cir.1997) ("nothing in this record leads us to believe the agents misled him or exploited Mr. Westbrook's anxiety to the point that he was unable to make a rational decision about whether to confess"); Sprosty v. Buchler, 79 F.3d 635, 647 (7th Cir.1996) ("the police did not magnify or exploit Sprosty's fears, anxieties and uncertainties to the point where he was unable to make a rational decision about whether to confess"); United States v. Doucette, 979 F.2d 1042, 1045 (5th Cir.1992) ("a confession is voluntary if, under the 'totality of the circumstances,' the statement is the product of the accused's 'free and rational choice' "); United States v. Velasquez, 885 F.2d 1076, 1089 (3d Cir.1989) ("although the deception [by the police] may have been a partial cause of Velasquez's statements, we do not think that her will was overcome or her capacity for self-control vitiated"); United States v. Guerrero, supra, 847 F.2d at 1365 ("an inculpatory statement is voluntary only when it is the product of a rational intellect and a free will"). We might have a more difficult case had Furnas gone further and promised the Kontnys they would not be prosecuted if they played ball with him, for that conceivably is the kind of false promise that might induce a rational person to rely. United States v. Baldwin, 60 F.3d 363, 365 (7th Cir.1995), vacated and remanded on other grounds, 517 U.S. 1231, 116 S.Ct. 1873, 135 L.Ed.2d 169 (1996); United States v. Rutledge, supra, 900 F.2d at 1130. Furnas did not do that. On the contrary, he as much as warned the Kontnys that any evidence they provided of fraud would lead to a criminal investigation. As we have said, he didn't have to go further and give them Miranda warnings.

It is true that the Internal Revenue Service by regulation requires that a civil investigation cease when the investigator develops firm indications of fraud, Internal Revenue Manual § § 4565.21(1), 9311.83(1), which the Kontnys argue happened before the fatal interview and the check-shredding phone conversation. But the federal exclusionary rule, which forbids the use of evidence obtained in violation of the Fourth or Fifth Amendments, does not extend to violations of statutes and regulations. The Supreme Court so held in United States v. Caceres, 440 U.S. 741, 755, 99 S.Ct. 1465, 59 L.Ed.2d 733 (1979), with specific reference to a regulation of the IRS. See also United States v. Peters, 153 F.3d 445, 456 (7th Cir.1998); United States v. Michaud, 860 F.2d 495, 498-99 (1st Cir.1988); Groder v. United States, 816 F.2d 139, 142 (4th Cir.1987), and, for application of the principle outside the tax area, United States v. Chaparro-Alcantara, 226 F.3d 616, 621 (7th Cir.2000); United States v. Page, 232 F.3d 536, 2000 WL 1682523, at *3 (6th Cir. Nov. 9, 2000); United States v. Hinton, 222 F.3d 664, 674-75 (9th Cir.2000); United States v. Felipe, 148 F.3d 101, 109 (2d Cir.1998); United States v. Hensel, 699 F.2d 18, 29-30 (1st Cir.1983). The Kontnys do not claim to have relied, reasonably or unreasonably, on the existence of the regulation that required Furnas to back off as soon as he obtained firm indications of fraud. United States v. Caceres, supra, 440 U.S. at 752-53, 99 S.Ct. 1465; United States v. Ani, 138 F.3d 390, 392 (9th Cir.1998); United States v. Pipes, 87 F.3d 840, 842 (6th Cir.1996). But this means, as Pipes makes clear, that there was no causal relation between Furnas's alleged violation of the regulation and the Kontnys' decision to make incriminating statements. "The defendant obviously did not know that the officers were violating [the statute]. Thus, the

officers' failure to comply with [it] had no impact on defendant's decision to commit the offense." Id. Nor is there any suggestion that Furnas violated the prohibition against enforcement of a summons for tax records after a matter has been referred to the Justice Department for possible criminal prosecution. 26 U.S.C. § 7602(c)(1); United States v. Michaud, 907 F.2d 750 (7th Cir.1990) (en banc).

A number of decisions explore at length the nebulous distinction in the IRS regulation between "first" and "firm" indications of fraud; Furnas only admitted that he had the former sort before he interviewed the Kontnys. But the cases generally and we think rightly do not treat the distinction as an independent basis for determining whether evidence obtained in an IRS investigation is admissible. They treat it merely as a factor to be considered in evaluating the defendant's constitutional claim. The defendant must prove that "the IRS's conduct resulted in prejudice to defendant's constitutional rights." United States v. Peters, supra, 153 F.3d at 452 n. 10; see also United States v. Grunewald, 987 F.2d 531, 534 (8th Cir.1993); United States v. Knight, 898 F.2d 436, 438 (5th Cir.1990), and the concurring opinion in Peters, 153 F.3d at 462-64.

There are some outliers, such as United States v. McKee, 192 F.3d 535, 541 (6th Cir.1999), which states (in dicta, as the concurring judge pointed out, id. at 545), reflecting a common but perhaps excessive hostility to the Internal Revenue Service, that section 4565.21(1) of the IRS manual is "mandated by the Constitution." It is true as we have noted that Caceres left the door slightly ajar by indicating that it might be a denial of due process to induce reasonable reliance

on the regulation and then pull the rug out from under the defendant; but nothing of that kind is involved in this case. United States v. Tweel, 550 F.2d 297, 299 (5th Cir.1977), contains broad McKee-like language, and has been cited frequently. But besides having been decided before Caceres, it was a case, unlike ours, involving the issue of consent to a search, and the defendant in giving his consent was held to have relied reasonably on the agent's promise that the investigation was purely civil. United States v. Powell, 835 F.2d 1095, 1098 (5th Cir.1988). The government had broken its promise, and we know that admissions extracted by false promises are sometimes excluded as being involuntary. There were no promises in the present case.

Peters goes on to state that the defendant must show "affirmative misrepresentations," "affirmative deceit," or "affirmative misleading" (153 F.3d at 456-57) (these terms are synonymous), but it would be a mistake to infer that such a showing without more requires exclusion of incriminating statements. Proof of deceit must be linked up to the constitutional standard of threat or promise. Deceit by itself is neither, though it can be the basis of either — if Furnas had pretended to be a representative of the Mob and told the Kontnys that they would be killed if they didn't turn over their business records to him, or pretended to be an Assistant U.S. Attorney and assured them they would not be prosecuted if they cooperated with him, the Kontnys might have a sound ground for exclusion. Cf. Arizona v. Fulminante, 499 U.S. 279, 287-88, 111 S.Ct. 1246, 113 L.Ed.2d 302 (1991). They showed nothing of the sort, and must therefore lose even if the district court clearly erred (the applicable standard of appellate review, United States v. Peters, supra, 153 F.3d at

459; United States v. McKee, supra, 192 F.3d at 543; United States v. Wadena, 152 F.3d 831, 851 (8th Cir.1998)) — which, incidentally, it did not — in finding that Furnas did not have firm indications of fraud before he interviewed the Kontnys. That issue is not determinative. A failure to terminate a civil investigation when the revenue agent has obtained firm indications of fraud does not without more establish the inadmissibility of evidence obtained by him in continuing to pursue the investigation. There is nothing more here.

Moving to the sentencing issue, we confront the argument that the efforts the Kontnys made to conceal their scheme of tax evasion did not amount to the "sophisticated concealment" that requires a two-level sentencing bonus under U.S.S.G. § 2T1.4(b)(2). That they did make such efforts is not in question. They wrote separate checks to the employees, one for regular wages and one for overtime, and sometimes the overtime checks would include reimbursement for expense items to disguise the fact that the checks were for wages. The Kontnys programmed their computer so that the amount of the overtime checks was classified in nonwage expense categories. The stubs for the overtime checks, which they gave their accountant, likewise placed the expense in nonwage categories.

But did these efforts amount to "sophisticated concealment"? They were not very sophisticated in the lay sense of the word, especially in context. By creating a fraud that involved the knowing participation of more than two dozen employees, they not only armed the employees to blackmail them but greatly increased the risk of eventual

detection, though it is true that the fraud persisted for at least a decade before the inevitable occurred. The Kontnys' efforts at concealment were sophisticated in relation to a case in which the owner of a shop evades taxes by emptying the drawer of the cash register before counting the day's cash receipts and puts the cash thus skimmed into a shoebox and slides it under his bed, but unsophisticated in relation to a scheme of evasion that does not depend on the continuing goodwill of one's entire workforce and that creates a paper trail that is more difficult to follow to its guilty conclusion than the one the Kontnys created.

The existence of a statutory sentencing range reflects the fact that criminal acts that involve the same statutory elements (in the case of criminal tax fraud they are essentially that the defendant knowingly made a materially false return, 26 U.S.C. § 7206(1); United States v. Pirro, 212 F.3d 86, 89 (2d Cir.2000)) may differ in circumstances that are pertinent to the appropriate penalty. One criminal act may be much more lucrative for the offender because it involves a very large amount of money relative to the cost of committing the offense, and so a heavier punishment will be necessary to deter. Another may be more lucrative than the average not because it involves a larger take but because the probability of detection is lower; an economist would say in such a case that the "expected" profit of the crime was greater. The existence of a sentencing range as opposed to a sentencing point allows these differences to be reflected in sentencing. The federal sentencing guidelines guide and discipline the judge's choice of the sentence within the range. They do this by fixing a sentencing range (narrower than the statutory range) for the average offense within the offense

category (here, criminal tax fraud) and by prescribing bonuses and discounts to adjust for relevant differences between the average and the particular offender's offense.

The more sophisticated the efforts that an offender employs to conceal his offense, the less likely he is to be detected, and so he should be given a heavier sentence to maintain the same expected punishment, and hence the same deterrence, that confronts the average offender. Implementation of this rule requires both determining how much the average offense is concealed and relating the guideline concept of "sophistication" to deterrent needs. The complication in the first half of this inquiry is that fraud is by nature self- concealing — its success depends on its being hidden from the victim. The average criminal tax fraud thus involves some concealment; "sophisticated" tax fraud must require more. A parallel distinction has arisen in determining when statutes of limitations in fraud cases are tolled. If concealment were enough to toll such a statute of limitations, the statute would be tolled in almost every case, because fraud is inherently covert. So the courts distinguish between the initial fraud and any distinct efforts at cover up ("fraudulent concealment") and toll the statute only when the defendant has resorted to such efforts. Wolin v. Smith Barney Inc., 83 F.3d 847, 851 (7th Cir.1996); Martin v. Consultants & Administrators, Inc., 966 F.2d 1078, 1093-95 (7th Cir.1992). Likewise the concealment that is inherent in criminal tax fraud, as in our shoebox example, must be distinguished from efforts over and above that concealment to prevent detection. Only the latter permit the sentencing enhancement.

In light of its purpose and context, we think "sophistication" must refer not to the elegance, the "class," the "style" of the defrauder — the degree to which he approximates Cary Grant — but to the presence of efforts at concealment that go beyond (not necessarily far beyond, for it is only a two-level enhancement that is at issue, which in this case added roughly six months to the defendants' sentences) the concealment inherent in tax fraud. It is true that the guideline commentary illustrates with examples suggesting a higher level of financial sophistication: " 'sophisticated concealment' means especially complex or especially intricate offense conduct in which deliberate steps are taken to make the offense, or its extent, difficult to detect. Conduct such as hiding assets or transactions, or both, through the use of fictitious entities, corporate shells, or offshore bank accounts ordinarily indicates sophisticated concealment." U.S.S.G. § 2T1.4, Application Note 3. But these are offered as examples, as emphasized in United States v. Friend, 104 F.3d 127, 130 (7th Cir.1997), and United States v. Clements, 73 F.3d 1330, 1340 (5th Cir.1996); the essence of the definition is merely "deliberate steps taken to make the offense . . difficult to detect." When the term "sophisticated" is defined so, it becomes apparent that the district judge did not commit a clear error (the applicable standard of appellate review of this ruling too, e.g., United States v. Madoch, 108 F.3d 761, 765 (7th Cir.1997); United States v. Aragbaye, 234 F.3d 1101, 1107 (9th Cir.2000)) in enhancing the defendants' sentences.

The Kontnys point out that the government rarely prosecutes criminal tax fraud that is not "sophisticated" in the sense indicated by the facts of this case. Armed as it is

with fearsome civil remedies involving huge penalties — for example the 75 percent penalty for taxes fraudulently not paid, 26 U.S.C. § 6663 — the government brings few criminal tax cases (fewer than 700 a year) relative to the amount of tax fraud; and perhaps none against defendants less sophisticated than the Kontnys. We do not know this to be the case, but will assume it is for the sake of argument. No matter. The question is what the Sentencing Commission took to be the average criminal tax fraud when it promulgated the "sophisticated concealment" guideline back in 1987. That would be the benchmark for courts to use to decide whether the Commission would have wanted the sentences of the Kontnys increased by reason of the character or extent of their efforts at concealment. The government's lawyer told us without contradiction from his opponent that before the guidelines era the federal government prosecuted many unsophisticated criminal tax frauds, as illustrated by our shoebox case. The defendant would usually plead guilty and the judge impose a light sentence ("roughly half of all tax evaders were sentenced to probation without imprisonment, while the other half received sentences that required them to serve an average prison term of twelve months," U.S.S.G. § 2T1.1, Background Commentary), and sentences in those days were essentially unappealable unless they exceeded the statutory maximum. So these were easy cases for the government. When the guidelines came into force, limiting sentencing discretion, the government shifted its focus to the more serious cases, not wanting to become involved in trials of minor cases when under the guidelines defendants might be reluctant to plead guilty because they would be facing a heavier sentence and might, like so many other federal criminal defendants these days, appeal their

sentences. So today the average criminal tax fraud that is prosecuted is more sophisticated than when the concept of sophistication was introduced into the guidelines. That is no reason for thinking the Commission would consider the enhancement imposed in this or like cases excessive even if they are the only type of criminal tax fraud being prosecuted nowadays.

AFFIRMED.

APPENDIX B — JUDGMENT OF THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF WISCONSIN AS TO KENNETH P. KONTNY DATED JULY 27, 2000 AND FILED JULY 28, 2000

UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF WISCONSIN

Case Number: 3:00CR00004-001

UNITED STATES OF AMERICA

v.

KENNETH P. KONTNY

JUDGMENT IN A CRIMINAL CASE
(For Offenses Committed On or After November 1, 1987)

The defendant, Kenneth P. Kontny, was represented by Michael G. Goller.

The Defendant was found guilty on count(s) 1, 3, 5, 6, 8 and 10 of the Superseding Indictment.

Appendix B

Title & Section	Nature of Offense	Date Offense Concluded	Count Numbers
18 U.S.C. § 371	Conspiracy, a Class D Felony	06/1995	1
26 U.S.C. § 7206(1)	Fraud, a Class E Felony	01/27/1994	3
26 U.S.C. § 7206(1)	Fraud, a Class E Felony	04/28/1994	5
26 U.S.C. § 7206(1)	Fraud, a Class E Felony	07/28/1994	6
26 U.S.C. § 7206(1)	Fraud, a Class E Felony	10/28/1994	8
26 U.S.C. § 7206(1)	Fraud, a Class E Felony	01/30/1995	10

The defendant is sentenced as provided in pages 2 through 7 of this judgment. The sentence is imposed pursuant to the Sentencing Reform Act of 1984.

Defendant shall notify the United States Attorney for this district within 30 days of any change of name, residence, or mailing address until all fines, restitution, costs, and special assessments imposed by this judgment are fully paid.

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July 26, 2000
Date of Imposition of Judgment

s/ John C. Shabaz
JOHN C. SHABAZ
District Judge

Date: July 27, 2000

Defendant's Soc. Sec. No.: 536-44-6922
Defendant's Date of Birth: 09/06/1949
Defendant's USM No.: 04673-090

Defendant's Residence Address:
1501 11th Avenue West
Ashland, WI 54806

Mailing Address:
Same

IMPRISONMENT

As to each of Counts 1, 3, 5, 6, 8 and 10, the defendant is committed to the custody of the Bureau of Prisons for imprisonment for a term of 32 months. The terms of imprisonment for all counts are to be served concurrently.

The Court makes the following recommendations to the Bureau of Prisons:

The Court recommends that the defendant be allowed pre-release placement not to exceed 90 days in a community corrections center with work-release privileges but without home confinement.

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The defendant is neither a flight risk nor a danger to the community. Execution of the sentence of imprisonment only is stayed until October 2, 2000, between 12:00 noon and 3:00 p.m., when the defendant is ordered to self-surrender to the Bureau of Prisons at an institution to be designated by further court order. The defendant's release on bail and all conditions of pretrial services supervision are continued until October 2, 2000.

* * *

SUPERVISED RELEASE

The sentence of imprisonment for Count 1 is to be followed by a three-year term of supervised release. The sentences of imprisonment for the remaining counts are to be followed by a one-year term of supervised release. All terms of supervised release are to run concurrently.

Defendant shall report to the probation office in the district to which defendant is released within 72 hours of release from the custody of the Bureau of Prisons.

While on supervised release, defendant shall not commit another federal, state, or local crime.

While on supervised release, defendant shall not illegally possess a controlled substance.

If defendant has been convicted of a felony, defendant shall not possess a firearm or destructive device, while on supervised release.

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Defendant shall comply with the standard conditions that have been adopted by this court (set forth on the next page). Defendant shall also comply with the following special conditions.

1. Register with local law enforcement agencies and the state attorney general as directed by the supervising U.S. probation officer;

2. Provide financial information as directed by the supervising U.S. probation officer;

3. Cooperate with the IRS in payment of back taxes, including penalties and interest, and file all income tax returns in a timely manner as required by the IRS.

Because the defendant has no history of substance abuse, the mandatory drug test condition is waived.

STANDARD CONDITIONS OF SUPERVISION

1) Defendant shall not leave the judicial district without the permission of the court or probation officer;

2) Defendant shall report to the probation officer as directed by the court or probation officer and shall submit a truthful and complete written report within the first five days of each month;

3) Defendant shall answer truthfully all inquiries by the probation officer and follow the instructions of the probation officer;

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4) Defendant shall support his or her dependents and meet other family responsibilities;

5) Defendant shall work regularly at a lawful occupation unless excused by the probation officer for schooling, training, or other acceptable reasons;

6) Defendant shall notify the probation officer within seventy-two hours of any change in residence or employment;

7) Defendant shall refrain from excessive use of alcohol and shall not purchase, possess, use, distribute or administer any narcotic or other controlled substance, or any paraphernalia related to such substances except as prescribed by a physician;

8) Defendant shall not frequent places where controlled substances are illegally sold, used, distributed, or administered;

9) Defendant shall not associate with any persons engaged in criminal activity, and shall not associate with any person convicted of a felony unless granted permission to do so by the probation officer;

10) Defendant shall permit a probation officer to visit him or her at any time at home or elsewhere and shall permit confiscation of any contraband observed in plain view by the probation officer;

11) Defendant shall notify the probation officer within seventy-two hours of being arrested or questioned by a law enforcement officer;

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12) Defendant shall not enter into any agreement to act as an informer or a special agent of a law enforcement agency without the permission of the court;

13) As directed by the probation officer, defendant shall notify third parties of risks that may be occasioned by the defendant's criminal record or personal history or characteristics, and shall permit the probation officer to make such notifications and to confirm defendant's compliance with such notification requirement.

FINANCIAL PENALTIES

Defendant shall pay the following total financial penalties in accordance with the schedule of payments set forth below.

Count	Assessment	Fine
1	$ 50.00	*$10,000.00*
3	$ 50.00	*$10,000.00*
5	$ 50.00	*$10,000.00*
6	$ 50.00	*$10,000.00*
8	$ 50.00	*$10,000.00*
10	$ 50.00	*$10,000.00*
Total	$300.00	$60,000.00

* * *

The defendant's criminal conduct occurred prior to April 24, 1996, the date on which the Mandatory Victim Restitution Act became effective. As to each of Counts 1, 3, 5, 6, 8, and 10 of the superseding indictment, it is

adjudged that the defendant shall pay a $50 criminal assessment penalty for a total of $300, to the Clerk of Court, Western District of Wisconsin, immediately following sentencing. The defendant possesses the financial assets to pay a fine without hindering his ability to support himself and his wife. The defendant is ordered to pay a fine of *$10,000* per count for a total of *$60,000*. This is due immediately and is to be paid to the Clerk of Court, Western District of Wisconsin. Interest is to accrue on the unpaid portion of the fine at the statutory rate. It is further ordered that the defendant is to pay $9,524.83 for the costs of prosecution immediately following sentencing. The costs of prosecution are ordered to be paid jointly and severally with the co-defendant.

SCHEDULE OF PAYMENTS

Payments shall be applied in the following order: (1) assessment; (2) restitution; (3) fine principal; (4) cost of prosecution; (5) interest; (6) penalties.

STATEMENT OF REASONS

The Court adopts the guideline calculations proposed by the probation office using the 1998 guidelines manual. In calculating the sentencing guidelines, the Court has considered all activities which were part of the same course of conduct or common scheme or plan as the offense of conviction as defined in § 1B1.3.

The defendant's total offense level is 19, and his criminal history category is I. This results in a guideline sentencing range of 30-37 months. The offense level is determined by

a tax loss of approximately $57,535. There is a two-level increase for sophisticated means of avoiding taxes, a two-level increase for encouraging others and a two-level increase for obstruction. There is no decrease for acceptance of responsibility because this matter was taken to trial, and the defendant has shown no inclination to accept responsibility for his actions. The amount of tax loss as determined by the government is a conservative estimate and does not include the potential tax loss for the first 3 quarters of 1992. The records for 1992 had been destroyed and were not available to the government.

The defendant's attempts to reduce the reasonably conservative estimate for tax loss are to no avail. The loss is that which would have resulted had this sophisticated and especially complex and intricate criminal scheme been completed. See paragraph 11 of the Pre-Sentence Report which the Court adopts. It was so sophisticated that the first Internal Revenue Service audit failed to discover the scheme after which the co-defendant destroyed 1992 tax records. Deductions for payment of FICA are not granted and the government's determinations of payments received by an employee other than overtime are found to be reasonable and overly generous to the defendant. Although the ultimate burden is on an employee to pay taxes on his or her wages, the employer's failure to make these deductions does not excuse the loss which it caused, particularly where the employee was encouraged by the defendant to be a part of the scheme and was neither furnished W-2's nor information on the amount of overtime on which to pay income taxes.

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Regardless of defendant's false testimony at trial where he totally denied any such conversations at page 97 of his transcript, he did encourage employees to violate I.R.S. laws by accepting overtime payments without taxes being withheld all as set forth in paragraph 12 of this Pre-Sentence Report which the Court also adopts. He further denied that he knew overtime was not on the W-2's which were provided to his employees and denied that he asked Agent Furnas whether he should file amended W-2's. He even denied ever having seen a Form 941 and testified that the scheme was that of the co-defendant and an employee even though he was the CEO. Clearly defendant Kenneth Kontny at trial intentionally provided false material testimony for the purpose of obstructing and impeding the administration of justice.

A sentence of imprisonment at the middle of the guideline range will take into account the additional tax loss. A sentence of imprisonment at the middle of the guideline range, coupled with a fine and a three-year term of supervised release, will provide deterrence, reflect the seriousness of the offense, and hold defendant accountable for his actions.

Guideline Range Determined by the Court:

Total Offense Level: 19
Criminal History Category: I
Imprisonment Range: 30 to 37 months
Supervised Release: 2 to 3 years
Fine Range: $6000 to $60,000
Restitution: N/A
Special Assessment: $300.00

APPENDIX C — JUDGMENT OF THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF WISCONSIN AS TO JOANN L. KONTNY DATED JULY 27, 2000 AND FILED JULY 28, 2000

UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF WISCONSIN

Case Number: 3:00CR00004-002

UNITED STATES OF AMERICA

v.

JOANN L. KONTNY

JUDGMENT IN A CRIMINAL CASE
(For Offenses Committed On or After November 1, 1987)

The defendant, JoAnn L. Kontny, was represented by Robert E. Meldman.

The Defendant was found guilty on count(s) 1, 2, 4, 7 and 9 of the Superseding Indictment.

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Title & Section	Nature of Offense	Date Offense Concluded	Count Numbers
18 U.S.C. § 371	Conspiracy, a Class D Felony	06/1995	1
26 U.S.C. § 7206(1)	Fraud, a Class E Felony	01/27/1994	2
26 U.S.C. § 7206(1)	Fraud, a Class E Felony	04/28/1994	4
26 U.S.C. § 7206(1)	Fraud, a Class E Felony	10/28/1994	7
26 U.S.C. § 7206(1)	Fraud, a Class E Felony	01/30/1995	9

The defendant is sentenced as provided in pages 2 through 7 of this judgment. The sentence is imposed pursuant to the Sentencing Reform Act of 1984.

Defendant shall notify the United States Attorney for this district within 30 days of any change of name, residence, or mailing address until all fines, restitution, costs, and special assessments imposed by this judgment are fully paid.

Appendix C

July 26, 2000
Date of Imposition of Judgment

s/ John C. Shabaz
JOHN C. SHABAZ
District Judge

Date: July 27, 2000

Defendant's Soc. Sec. No.: 536-44-6922
Defendant's Date of Birth: 10/28/1950
Defendant's USM No.: 04672-090

Defendant's Residence Address:
1501 11th Avenue West
Ashland, WI 54806

Mailing Address:
Same

IMPRISONMENT

As to each of Counts 1, 2, 4, 7 and 9, the defendant is committed to the custody of the Bureau of Prisons for imprisonment for a term of 27 months. The terms of imprisonment for all counts are to be served concurrently.

The court makes the following recommendations to the Bureau of Prisons:

The Court recommends that the defendant be allowed pre-release placement not to exceed 90 days in a community corrections center with work-release privileges but without home confinement.

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The defendant is neither a flight risk nor a danger to the community. Execution of the sentence of imprisonment only is stayed until October 10, 2000, between 12:00 noon and 3:00 p.m., when the defendant is ordered to self-surrender to the Bureau of Prisons at an institution to be designated by further court order. The defendant's release on bail and all conditions of pretrial services supervision are continued until October 10, 2000.

* * *

SUPERVISED RELEASE

The sentence of imprisonment for Count 1 is to be followed by a three-year term of supervised release. The sentences of imprisonment for the remaining counts are to be followed by a one-year term of supervised release. All terms of supervised release are to run concurrently.

Defendant shall report to the probation office in the district to which defendant is released within 72 hours of release from the custody of the Bureau of Prisons.

While on supervised release, defendant shall not commit another federal, state, or local crime.

While on supervised release, defendant shall not illegally possess a controlled substance.

If defendant has been convicted of a felony, defendant shall not possess a firearm or destructive device, while on supervised release.

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Defendant shall comply with the standard conditions that have been adopted by this court (set forth on the next page). Defendant shall also comply with the following special conditions.

1. Register with local law enforcement agencies and the state attorney general as directed by the supervising U.S. probation officer;

2. Provide financial information as directed by the supervising U.S. probation officer;

3. Cooperate with the IRS in payment of back taxes, including penalties and interest, and file all income tax returns in a timely manner as required by the IRS.

Because the defendant has no history of substance abuse, the mandatory drug test condition is waived.

STANDARD CONDITIONS OF SUPERVISION

1) Defendant shall not leave the judicial district without the permission of the court or probation officer;

2) Defendant shall report to the probation officer and shall submit a truthful and complete written report within the first five days of each month;

3) Defendant shall answer truthfully all inquiries by the probation officer and follow the instructions of the probation officer;

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4) Defendant shall support his or her dependents and meet other family responsibilities;

5) Defendant shall work regularly at a lawful occupation unless excused by the probation officer for schooling, training, or other acceptable reasons;

6) Defendant shall notify the probation officer ten days prior to any change in residence or employment;

7) Defendant shall refrain from excessive use of alcohol;

8) Defendant shall not frequent places where controlled substances are illegally sold, used, distributed, or administered;

9) Defendant shall not associate with any persons engaged in criminal activity, and shall not associate with any person convicted of a felony unless granted permission to do so by the probation officer;

10) Defendant shall permit a probation officer to visit him or her at any time at home or elsewhere and shall permit confiscation of any contraband observed in plain view of the probation officer;

11) Defendant shall notify the probation officer within seventy-two hours of being arrested or questioned by a law enforcement officer;

12) Defendant shall not enter into any agreement to act as an informer or a special agent of a law enforcement agency without the permission of the court;

13) As directed by the probation officer, the defendant shall notify third parties of risks that may be occasioned by the defendant's criminal record or personal history or characteristics, and shall permit the probation officer to make such notifications and to confirm the defendant's compliance with such notification requirement.

FINANCIAL PENALTIES

Defendant shall pay the following total financial penalties in accordance with the schedule of payments set forth below.

Count	Assessment	Fine
1	$ 50.00	*$10,000.00*
2	$ 50.00	*$10,000.00*
4	$ 50.00	*$10,000.00*
7	$ 50.00	*$10,000.00*
9	$ 50.00	*$10,000.00*
Total	$250.00	*$50,000.00*

* * *

The defendant's criminal conduct occurred prior to April 24, 1996, the date on which the Mandatory Victim Restitution Act became effective. As to each of Counts 1, 2, 4, 7 and 9 of the superseding indictment, it is adjudged that the defendant shall pay a $50 criminal assessment penalty for a total of $250, to the Clerk of Court, Western District of Wisconsin, immediately following sentencing. The defendant possesses the financial assets to pay a fine without

hindering her ability to support herself. The defendant is ordered to pay a fine of *$10,000* per count for a total of *$50,000*. This is due immediately and is to be paid to the Clerk of Court, Western District of Wisconsin. Interest is to accrue on the unpaid portion of the fine at the statutory rate. It is further ordered that the defendant is to pay $9,524.83 for the costs of prosecution immediately following sentencing. The costs of prosecution are ordered to be paid jointly and severally with the co-defendant.

SCHEDULE OF PAYMENTS

Payments shall be applied in the following order: (1) assessment; (2) restitution; (3) fine principal; (4) cost of prosecution; (5) interest; (6) penalties.

STATEMENT OF REASONS

The Court adopts the guideline calculations proposed by the probation office using the 1998 guidelines manual. In calculating the sentencing guidelines, the Court has considered all activities which were part of the same course of conduct or common scheme or plan as the offense of conviction as defined in § 1B1.3.

The defendant's total offense level is 17, and her criminal history category is I. This results in a guideline sentencing range of 24-30 months. The offense level is determined by a very conservative tax loss of approximately $57,535. There is a two-level increase for sophisticated means of avoiding taxes, and a two-level increase for encouraging others. There is no decrease for acceptance of responsibility

because this matter was taken to trial, and the defendant has shown no inclination to accept responsibility for her actions. The amount of tax loss as determined by the government is a conservative estimate and does not include the potential tax loss for the first 3 quarters of 1992. The records for 1992 had been destroyed and were not available to the government.

The defendant's attempts to reduce the reasonably conservative estimate for tax loss are to no avail. The loss is that which would have resulted had this sophisticated and especially complex and intricate criminal scheme been completed. See paragraph 11 of the Pre-Sentence Report which the Court adopts. It was so sophisticated that the first Internal Revenue Service audit failed to discover the scheme after which the defendant destroyed 1992 tax records. Deductions for payment of FICA are not granted and the government's determinations of payments received by an employee other than overtime are found to be reasonable and overly generous to the defendant. Finally, because the ultimate burden is on an employee to pay taxes on his or her wages, the employer's failure to make these deductions does not excuse the loss which it caused, particularly where the employee was encouraged by the defendant to be a part of the scheme and was neither furnished W-2's nor information on the amount of overtime on which to pay income taxes.

It was also reasonably foreseeable to this defendant that her co-defendant encouraged employees to violate I.R.S. laws by accepting overtime payments without taxes being withheld all as set forth in paragraph 12 of this Pre-Sentence Report which the Court also adopts.

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A sentence of imprisonment at the middle of the guideline range, coupled with a fine and a three-year term of supervised release, will provide deterrence, reflect the seriousness of the offense, and hold defendant accountable for her actions.

Guideline Range Determined by the Court:

Total Offense Level: 17

Criminal History Category: I

Imprisonment Range: 24 to 30 months

Supervised Release: 2 to 3 years

Fine Range: $5000 to $50,000

Restitution: N/A

Special Assessment: $250.00

APPENDIX D — MEMORANDUM AND ORDER OF THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF WISCONSIN DATED AND ENTERED MAY 1, 2000

IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF WISCONSIN

00-CR-004-S

UNITED STATES OF AMERICA,

Plaintiff

v.

KENNETH P. KONTNY and JO ANN L. KONTNY,

Defendants.

MEMORANDUM and ORDER

Defendants, Kenneth P. Kontny and Jo Ann L. Kontny are charged with substantive tax counts and a conspiracy count concerning their alleged willful evasion of employment taxes in 1993 and 1994. Defendants move to suppress statements they made and documents they produced on March 13, 1995 to Internal Revenue Service Agent James M. Furnas.

On March 27, 2000 the Honorable Steven L. Crocker, United States Magistrate Judge for the Western District of Wisconsin, held an evidentiary hearing on defendants'

motion to suppress. The Magistrate Judge issued a report and recommendation recommending that defendants' motion to suppress statements and evidence be denied.

On May 1, 2000 defendants filed their objections to the Magistrate Judge's recommendation that their motion to suppress be denied. Pursuant to 28 U.S.C. §636(b)(1)(C) this Court reviews the report and recommendation.

FACTS

After reviewing defendants' objections to the Magistrate Judge's Findings of Fact, the Court finds the following facts.

On October 12, 1994, George Sundstrom, a union representative, spoke with Internal Revenue Special Agent Robert Babbitt in Duluth, Minnesota. Sundstrom advised him that a company in Wisconsin had 30 employees who were working 60 to 70 hours per week but whose overtime was not being recorded for payroll tax purposes. Babbitt made a computation on his rough notes of that meeting indicating that there would be approximately $390,000.00 of overtime pay on which employment taxes were not being paid. The employees did not want to come forward because they did not know whether they could obtain immunity. Sundstrom did not identify the employer or the employees.

After this meeting Agent Babbitt spoke with Revenue Agent Jim Furnas of the Civil Examination Division who had jurisdiction in Wisconsin. On February 16, 1995 John Raspotnik telephoned Agent Furnas and identified himself as one of the employees to whom Sundstrom had been

referring. He identified the employer as Tri-State Mechanical, Inc. in Ashland, Wisconsin. He stated that 10 to 12 employees were ready to come forward with information.

Prior to the meeting Agent Furnas telephoned Wisconsin IRS Criminal Investigation Division (CID) agent Bill Cunningham to discuss the investigation with him. Agent Furnas recorded this contact on his Case Activity Record.

On February 21, 1995 Agent Furnas met with John Raspotnik, Joe Raspotnik, Troy Weber and Brian Tarasewicz in John Raspotnik's home in Ashland, Wisconsin. Only John Raspotnik worked for Tri-State but the other three were former employees. They all provided information that the defendants, owners of Tri-State, had paid them overtime without book entries. They were angry at Tri-State for what they believed to be unfair labor practices. On February 22, 1995 Furnas contacted George Sundstrom who confirmed that these individuals had told him some of the same allegations.

Agent Furnas knew Jo Ann Kontny from his earlier audit in 1993 of KBK Services, the parent company of Tri-State, and Tri-State. On February 23, 1995 Furnas spoke with Jo Ann Kontny and arranged a meeting on February 28, 1995. Kontny rescheduled the meeting to March 13, 1995. Furnas did not believe he had a firm indication of fraud by the defendants because all the information he had obtained were unsubstantiated allegations by employees who were angry at the defendants.

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Furnas met with Jo Ann Kontny on March 13, 1995 at Tri-State. Furnas advised her that he was conducting a civil examination but that if he had reason to believe there was fraud involved he would refer the matter to the Criminal Investigation Division. Furnas told her he was investigating allegations that Tri-State was not withholding taxes on overtime wages paid to employees. Agent Furnas made an on-site review of Tri-State's Records and determined that several checks were missing from the register. Jo Ann Kontny advised Furnas that her husband would talk to him about the missing checks.

At about 2:00 p.m. Kenneth Kontny spoke with Furnas and admitted that Tri-State had made some overtime payments to workers that had not been included in the payroll for two to three years but had stopped about six months earlier. Furnas now had stronger indications that defendants had committed fraud but he had not examined all the records. After talking to his manager Furnas took the records from Tri-State and left a receipt. These records might have been obtained by means of an administrative summons.

On March 14, 1995 Furnas discovered that he did not have Tri-State's canceled checks for the first three quarters of 1992. He advised Jo Ann Kontny of this information, and she said she would send the checks to Furnas by courier. On March 15, 1995 Jo Ann Kontny telephoned Furnas to advise him that the checks had been shredded after the prior audit. Furnas interpreted Jo Ann Kontny's revelation of the shredded checks as showing intent to destroy the records. On March 16, 1995 Furnas suspended contact with the defendants and referred the matter to the Criminal Investigation Division.

Appendix D

MEMORANDUM

Defendants move to suppress the documents that they provided to Agent Furnas and the statements they made to him on March 13, 1995. They argue that this evidence was unlawfully obtained from them in violation of their Fourth and Fifth Amendment rights. Specifically, defendants contend that Agent Furnas had a firm indication of fraud and misrepresented to the defendants that his investigation was merely a civil audit.

To prevail on their motion defendants must produce clear and convincing evidence that the agent affirmatively misled them as to the true nature of his investigation. *United States v. Peters*, 153 F.3d 445, 451 (7th Cir. 1998). There is no evidence in the record that Agent Furnas affirmatively misled the defendants as to the true nature of his investigation. He advised Jo Ann Kontny of the allegations that had been made concerning the payment of overtime to employees. He also told her if he found some corroboration of the allegations he would refer the matter to the Criminal Investigation Division. The Court cannot conclude that the defendants believed they had no potential criminal exposure. The defendants were not misled or deceived by anything that Agent Furnas said or did on March 13, 1995.

The evidence could be suppressed under *Peters* where Agent Furnas had developed a firm indication of fraud before March 13, 1995 when he conducted his civil examination. An agent has a firm indication of fraud where he has developed a substantial understatement of tax coupled with an indication that understatement was deliberate. *Id.* at p. 455.

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Prior to March 13, 1995 Agent Furnas had only unsubstantiated allegations from disgruntled employees that Tri-State had not paid employment taxes. Defendants argue that because the employee witnesses demanded immunity the indications of fraud were firm. This request for immunity did not provide Agent Furnas with a firm indication of fraud. He needed to investigate to determine whether there was corroboration of the employees' allegations. Agent Furnas did, not have firm indications of fraud prior to March 13, 1995, and he did not mislead Jo Ann Kontny when he met with her.

The statements and evidence provided on March 13, 1995 were not obtained in violation of the defendants' Fourth and Fifth Amendment rights. Accordingly, their motion to suppress said evidence and statements will be denied. Since Agent Furnas did not mislead the defendants, the Court need not reach the government's argument that the evidence could have been obtained through the alternative means of issuance and enforcement of administrative summons.

The Court accepts the findings of fact and conclusions of law set forth in the report and recommendation as modified herein and adopts the recommendation of the Magistrate Judge. Defendants' motion to suppress statements and evidence will be denied.

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ORDER

IT IS ORDERED that the Magistrate Judge's recommendation is ADOPTED.

IT IS FURTHER ORDERED that defendants' motion to suppress statements and evidence is DENIED.

Entered this 1st day of May, 2000.

BY THE COURT:

s/ John C. Shabaz
JOHN C. SHABAZ
District Judge